IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 105 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and

Hon'ble MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME TAX

Versus

O.L. OF A'BAD MFG. AND CALICO PTG. CO. LTD.

Appearance:

MR MANISH R BHATT for Petitioner

NOTICE SERVED BY DS for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and

MR.JUSTICE A.R.DAVE

Date of decision: 18/12/98

ORAL JUDGEMENT

#. Heard Mr. M.R.Bhatt for the assessee as well as Ms. Hansa Punani for the Official Liquidator who now represents the respondent company now in liquidation.

#. The Income-tax Appellate Tribunal, Ahmedabad Bench 'C' , Ahmedabad has raised 6 questions arising out of its appellate order in ITA No.2466/Ahd/1977-78 dated 12.4.82 for the assessment year 1973-74. Question No.1 has been referred to us on an application under section 256(1) made by the Commissioner of Income-tax and the remaining 5 questions have been referred to us on the application of the assessee:

#. The following question has been referred to us at the instance of the revenue:

1. "Whether on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that the salaries and wages payable under the Industrial Tribunal's award dated 30th September 1971 which was disputed by the assessee, should be allowed as deduction while computing the income of the assessee ?

#. This is related to claim of the assessee for deduction of a sum of Rs.4,59,648.00 which became payable under the award of the Industrial Tribunal dated 30.9.71. The Income-tax Officer has rejected the said claim on the ground that since the assess is disputing its liability by challenging the award in higher forums and therefore, no deduction can be allowed. The Tribunal allowed the appeal after the AAC has confirmed the order of ITO following its earlier decision in ITA No. 2352 and 2559/Ahd/78-79 dated 29.10.79 holding that the liability to pay enhanced salaries and wages to its employees under the award can be allowed as in the year in question deduction while computing the income. The question answered is clearly governed by decision of the Division Bench of this Court to which one of us (A.R.Dave-J) was a party in ITR No.154 of 1983 decided on 1.4.98 and followed in assessee's own case in the earlier years which has been referred to by the Tribunal while deciding the appeal filed for the relevant year.

#. The court held that the liability to make payment pursuant to the said award had arisen and the award not having been stayed became operative and/or enforceable for the relevant assessment year. Therefore, since the liability had arisen under the award, it cannot be said

that it is not the liability of the assessee. Merely because the assessee has challenged the award, it does not make the award not enforceable and this remains the liability of the assessee to make payment under the relevant provisions of law. This court has enunciated the principle in ITR 363 of 1983 that the question whether the assessee is liable to a particular deduction or not would depend on the provisions of law relating thereto and not as per the assessment and the entries made in the books of accounts of the assessee. Aforesaid decision is squarely applicable to the facts of the present case. Therefore, we answer question no.1 stated above in the affirmative that is to say in favour of the assess and against the revenue.

#. Question no.2 referred to us reads as under:

"Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the assessee was not entitled to claim deduction of betterment levy of Rs. 48,409/- paid to Ahmedabad Municipal Corporation.?

It relates to the payment of Rs. 48,409/- which the assessee has made to the Ahmedabad Municipal Corporation during the assessment year in question as betterment levy. The assessee claimed deduction under section 37 of the Act. The Tribunal following its own decision in ITA No.2352/Ahd/77-78 decided on 29th October 1979 upholding the disallowance of the the assessee's claim for deduction on the ground that betterment charges are capital in nature and therefore, not allowed under section 37 of the Act. By a catena of decisions of this court it is well settled that betterment charges payable to the municipality is an expenditure of capital nature which included the assessee's own case arising out of the aforesaid appellate order of the Tribunal dated 29th October 1979. Reference may be made to the decisions in the case of Commissioner of Income-tax vs Ahmedabad Mfg. & Calico Printing Co. Ltd. 215 ITR 735 , CIT (Addl.) vs. Rohit Mills Ltd. 104 ITR 132 C.I.T vs. Mihir Textile Mills 104 ITR 167 and Commissioner of Income-tax, Gujarat vs. Ahmedabad Kaiser-I-Hind Mills Co. Ltd. 141 ITR 472. Following the aforesaid decisions we answer question no.2 in the affirmative that is to say in favour of the revenue and against the assessee.

#. Question no.3 reads as under:

"Wehther on the facts and in the circumstances of

the case, the Tribunal was justified in law in holding that the assessee was not entitled to Rs. 53,423/-?"

This question relates to the assessee's claim for deduction for the expenses incurred on account of issuance of certificate of shares , bonds etc. as a consequence of amalgamation that took place between the company and Bank of India Ltd. The Bank of India Ltd. amalgamated with the company with effect from 1.4.71. It was the case of the assessee that as expenditure has been incurred after the amalgamation became effective on 1.4.71 because of some administrative difficulties after amalgamation in issuing share certificates , bonds etc., same should be treated as expenditure allowable for the assessment year in question as business expenditure.

#. Section 37 of the Act has twin requirements before the same can be allowable as deduction in computation of the taxable income under the head profits and gains of business or profession. Firstly that the expenses must be laid out or expended wholly and exclusively for the purpose of business. In the second, it should not be in the nature of capital expenditure or personal expenses of the assessee. That the expenditure may have have been wholly laid out or expended for the purpose of business yet it would not qualify for deduction under section 37 of the Act if the same is of capital nature. Therefore the disallowance of the above mentioned expenses in the case of the company has been made is correct.

#. Whether an expenditure is revenue or capital is a vexed question. One test which is often quoted and followed in the words of Viscount Cave L.C. (1926) 10 Tax Case 155 in Atherton vs. British Insulated and Helsby Cables Ltd.that an expenditure is made not only once and for all but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. I think that there is very good reason in the absence of special circumstances leading to an appropriate conclusion for treating such an expenditure as properly attributable not to revenue but to capital.

##. Lawrence .J laid a test in Southern vs. Borax Consolidated (1942) 10 ITR (Supp) Vol.1 that where a sum of money is laid out for the acquisition or the

improvement of a fixed capital asset it is attributable to capital but that if no alteration is made in the fixed capital asset by the payment, then it is properly attributable to revenue, being in substance a matter of maintenance, the maintenance of the capital structure or the capital assets of the tax payer.

##. Lord Bowen in City of London Contract Corporation vs. Styles (1887) 2 TC 239 has observed "You do not use it for the purpose of your concern, which means , for the purpose of carrying on your concern, but you use it to acquire the concern.

##. In Assam Bengal Cement Co.Ltd. vs C.I.T (1955) 27 I.T.R. Supreme Court said,

"In cases where the expenditure is made for the capital outlay or for expansion of a business or substantial replacement of the equipment there is no doubt that it is capital expenditure"

##. In the context distinction between capital and revenue expenditure can broadly be stated thus expenditure on establishing, replacing, or enlarging the profit yielding subject or income earning apparatus is ordinarily of capital nature. On the other hand expenses incurred in the process of operating such profit yielding subject or income earning apparatus in the form of earning of profits it is of revenue nature.

##. Amalgamation of companies results in substance acquisition of transferor company by the transferee company resulting in alteration of its capital structure as well as frame work of business that is to say amalgamation is a event which concerns the corpus and in carrying on of business. Though it is a decision for better and profitable running of the business.

##. In 19 Tax Cases Lord Mc Millan has opined on construction of contracts in question, that there was an agreement which calls for consideration wherein the contractors were not dismissed of their contracts or failed to conduct of their business but they merely amalgamated the company to share the profits and earning as between the contracting parties.

##. Viewed from the aforesaid proposition one cannot

fail to perceive that the scheme of amalgamation is a transaction which affects the basic frame work of profit making apparatus of the company and is not an expenditure for operating that apparatus. Such expenses therefore, are not expenses for carrying on the business of the assessee but are for the purpose of acquiring or bringing change of permanent character in the structure of business and are of capital nature. The fact that expenses are to be incurred actually after the scheme has been put in operation on execution of the amalgamation scheme, would not alter the character of expenses which properly called were incurred in relation to amalgamation. The issuance of new share certificate or bonds to the members of the transferor company are necessary part of the amalgamation of the companies. and whether such expenses in connection therewith are incurred prior to the date with effect from which the amalgamation is effective or has in fact been incurred thereafter for any reasons would not alter the character of expenditure from capital to revenue.

##. In this connection we may refer to the decision in the case of Raza Buland Sugar Co.Ltd vs. Commissioner of Income-tax Delhi Central 122 ITR 817 The question related to allowing of the assessee company for deduction of the amount paid to the lawyer in connection with the amalgamation which was claimed as its business expenses. The assessee company was formed by the amalgamation of two companies namely, the Raza Sugar Company and the Buland Sugar Company. It was held that the legal expenses of Rs. 11,069/- were incurred before the assessee company came into being. They were integrally connected with the creation of the assessee company and were clearly capital in nature. Yet in another case in relation to the amalgamation of the same company Allahabad iHigh Court in the case of Raza Buland Sugar Co.Ltd. vs Commissioner of Income-tax 123 ITR 25 took the view that the expenses incurred in connection with the amalgamation had been incurred prior to its formation and were intergrally connected with the creation of the assessee company. The expenses were of capital nature and not allowable, but related to amalgamation expenses generally.

##. The fact that the court has observed that expenses were prior to its formation was only a statement of fact. But the decision is not founded on the basis whether expenses were incurred prior to or after amalgamation became effective . It would not make any difference for the present purpose inasmuch as the substance of the

issue is whether the expenses are in fact part of the amalgamation process. The expenses necessary for bringing into existence amalgamation being one relating to the structure of business are capital in nature. The fact that the liability has been discharged actually after amalgamation would not make any difference.

##. This court in an unreported decision in New Commercial Co. Ltd, Naroda Road, Ahmedabad vs. Addl.Commissioner of Income-tax Gujarat ITR No. 40 of 1972 has considered the question whether a sum of Rs. 10,000/- paid by the assessee company to the Chartered Accountant in relation to the scheme of amalgamation which was ultimately approved by this court was an admissible expenses under section 37 of the Income-tax Act or not. The court took notice of the fact that the main object of this arrangement is to effect internal economics with a view to bring down the cost of production and to utilise the capital equipments to the maximum advantage of both the units so as to obtain the optimum production and to stop competition between the two units. The court held that obviously, the services of the Chartered Accountants were utilised in order to get the advice regarding this scheme of amalgamation by which certain permanent benefits of enduring nature were obtained by the Company. The company's very structure was changed and the company by entering into this scheme of amalgamation got more share holders by the issue of shares as explained in the scheme of amalgamation which forms part of the amalgamation. Issue of share certificate and bonds by the transferee or new company coming into existence as a result of the scheme of amalgamation is in esence a part and parcel of execution of amalgamation scheme and cannot be divorced from it. In view of the aforesaid decisions, we come to the conclusion that the Tribunal was justified in holding that the assessee was not entitled to deduction of Rs. 53,423/- spent in connection with the issuance of share certificates and bonds as a part of amalgamation scheme and answer the question no.3 in the affirmative that is to say in favour of the revenue and against the assessee.

##. Question no.4 reads as under:

"Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the assessee was not entitled to claim u/s. 35B of the Act amounting to (a) Rs.3,40,208/- in regard to exchange and bank charges(b) insurance and freight amounting to

Rs.24,16,085/- ?

The assessee claimed weighted deduction in relation to two sets of expenditure. One amounting to Rs.3,40,208/- on account of exchange and bank charges and another amount of Rs. 24,16,085/- incurred on account of insurance and freight charges.

##. So far as the claim to deduction of expenses in connection with insurance and freight amounting to Rs. 24,16,085/- are concerned, the provision in relation thereto contained in sub clause (iii) of clause (b) to sub section 1 of section 35B are clear. It excludes the expenses incurred in India, in connection therewith or expenditure on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit do not qualify for weighted deduction under section 35B. This is also the view expressed by this court in the case of Isabgul Export Corporation vs. Commissioner of Income-tax 200 ITR 797 Thus the Tribunal was, in our opinion are justified in not allowing the deduction in respect of insurance and freight charges.

##. So far as the claim of weighed deduction of Rs. 3,40,208 in relation to exchange and bank charges are concerned, the claim made under section 35B(1)(b)(viii) of the Act. The expenditure became eligible allowance at weighted deduction of the expenses which are incurred wholly and exclusively for service outside India in connection with or incidental to the execution of any contract for the supply of goods outside India or such goods and services or facilities. The claim has been denied by the ITO solely on the ground that the assessee company simply reimbursed in India the exchange and bank charges incurred by Ilac Limited on its behalf. However, nothing has been stated about the purpose for which such expenses were incurred by the said Ilac Ltd. and whether the receipiant company rendered any service as is referred in sub-clause (viii) on behalf of the asessee or not. In the absence of such enquiry, it is not possible to come to any conclusion about the allowability of weighted deduction. It is not envisaged in the provision that services mentioned in sub clause (viii) must be rendered by the asessee personally and not through any agent. Nor is it envisaged that payment must be made only outside India for such services rendered outside India. It cannot also be said that if for rendering such services outside India, if any financial arrangements are

to be made and exchange or bank charges are to be incurred which are incidental and ancilliary to rendering of such services outside India, still the the same cannot be subjected to weighted deduction. However, before the question of admitting or not admitting any expenses, which are otherwise allowable as deduction to the benefit of weighted deduction such enquiry is essential. The AAC and the Tribunal made disallowance of the claim without recording any reasons. In our opinion on a plain reading of sub-clause (viii) of clause (b) of sub section 1 of section 35B it does not prohibit weighed deduction solely on the ground that the amount has been paid in India to some one without holding any inquiry for what purpose said amount has been paid. If the amount has been paid for the purposes of services outside India in connection with or incidental to the execution of any contract for suppllying outside India of such goods services or facilities which the assessee was bound to do irrespective of the fact whether such performance of services in connection with or incidental to the execution of any contract for outside India of such goods, services or facilities were performed or rendered by himself or through his agent the asessee will be entitled to weighted deduction. The question of disallowance cannot be decided without holding such enquiry. If the services of bank were obtained by the assessee for discharge of its obligation as envisaged under the aforesaid provision, the fact that the assessee has reimbursed the same who had initially incurred the expenses on behalf of the company and such expenses being reimbursed in India would be of a little relevance.

##. We therefore, answer question no.4 in the following manner.

(i) The claim of assessee relating to the insurance and freight charges amounting to Rs.24,16,086/- u/s 35B(b)(iii) of the Act, the Tribunal was justifi[ed in law in holding that the assessee was not entitled to claim weighed deduction under section 35B of the Act.

(ii) So far as the claim of Rs.3,40,208/regarding exchange and bank charges are concerned, we hold that the weighted deduction could not have been denied solely on the ground that the payment was made by way of reimbursement in India . However, the question whether the asessee is entitled to weighted deduction also cannot be decided solely on that basis. It must entail an inquiry whether the amount which was spent by the assessee by way of reimbursing to Ilac Ltd was incurred

wholly and exclusively for the purpose of such service outside India in connection with or incidental to , the execution of any contract for the supply outside India of such goods, services or facilities which the assessee was to perform or execute outside India.

##. Questions nos. 5 6 and which are interconnected, reads as under :

" (5) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the assessee was not entitled to claim the entire amount of gratuity of Rs. 1,54,00,000/- debited in the books of account u/s 28 r.w.s. 37 of the Act ?

" (6) Whether on the facts and in the circumstances of the case the Tribunal was justified in law in holding that the balance amount of Rs. 69,85,759/- was not allowable as gratuity liability even if the same was not provided for in the books of accounts of the assessee by holding that the appellant had followed cash system of accounting in respect of payment of gratuity to its employees ?

Both these questions relate to disallowance of assessee's claim to deduction on account of accrued liability of gratuity. The claim was rejected in view of the provisions of section 40A(7) of the Act of 1961 which was enacted with retrospective effect with effect from 1.4.73 requiring creation of an approved gratuity fund as a necessary condition before any provision for gratuity could be allowed under section 36(1)(v) of the Act. The assessee's claim was found either in section 28 or 47 of the Act. An amount of Rs.1,54,00,000/- being accrued liability of gratuity payable payable to the employees was debited in the books of accounts of the assessee in the profit and loss account . Another sum of Rs. 66,85,759/- was not at all debited to the profit and loss account or claimed as provisions for accrued liability on account of gratuity. The issue is now no more res integra in view of the decision in the case of Sajjan Mills 156 ITR 585 which lays down that before making any allowance on account of any provision made for gratuity which has accrued during the course of the year can only be considered on satisfying the conditions of section 40A(7) and not otherwise. In that view of the matter, we answer question nos 5 and 6 in the affirmative that is to

say in favour of the revenue and against the assessee.

##. This disposes of the present reference. There shall be no order as to costs.